

California Dairy Review

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Department Announces Milk Movement Hearing Decision

On July 6, 2006, the Department held a public hearing to consider amendments to the Milk Pooling Plan for Market Milk (Pool Plan) and to the Northern and Southern California Stabilization and Marketing Plans for Market Milk (Stab Plans). The amendments under consideration regarded changes to the milk movement incentive system. All changes will be effective September 1, 2006.

Having carefully weighed the contents of the hearing records, the Department has decided to make the following changes:

- Increases (+\$0.01 to +\$0.04/cwt) for seven of the eight transportation allowance rates in the three active Northern California receiving areas.
- Increases (+\$0.01 and +\$0.05/cwt) in two of the three mileage brackets for transportation allowance rates in the San Diego receiving area.
- Establish two separate sets of transportation allowance rates for the Southern California receiving area;
 - For milk from Riverside and San Bernardino counties, two mileage brackets with increases (+\$0.01 to +\$0.17/cwt) in the transportation allowance rates;
 - For milk from the other 56 California counties, four mileage brackets with increases (+\$0.01 to +\$0.17/cwt) in the transportation allowance rates, and with a change in the cutoff between the second and third bracket from 122 to 109 miles.
- Increase (+\$0.11/cwt) in the transportation credit rate within Southern California.
- Increase (+\$0.04/cwt) in the transportation credit rate to Southern California.
- Add Sacramento County as a Deficit County for receiving bulk milk from plants in the Supply Counties of Merced and part of Stanislaus at a rate of 0.20/cwt.

The Hearing Determinations, Panel Report, Pool Plan, Stab Plans and more detailed explanation of the Department's decision can be obtained on the CDFA dairy home page at www.cdfa.ca.gov/dairy. From this page, click on [Hearings] and then on [Dairy Hearing Matrix]. To access the Pool Plan and Stab Plans, click on [Dairy Regulations], located in the left hand column of the dairy home page. If you wish to receive a hard copy of the hearing results, please contact the Milk Pooling Branch at 916-341-5901 or the Dairy Marketing Branch at 916-341-5988. ☀



California Department of Food and Agriculture
A.G. Kawamura, Secretary

Production, Prices, Quota Transfers, Alfalfa

July Milk Production

Milk production in California for July 2006 totaled 3.12 billion pounds, down 0.1 percent from July 2005. USDA's estimate for U.S. milk production for July 2006 in the 23 major dairy states is 13.9 billion pounds, up 1.5 percent from July 2005. Production per cow in the 23 major states averaged 1,686 pounds for July, three pounds more than July 2005. ☀

Minimum Class Prices

Statewide average hundredweight prices

Class	July	August	Sept
1	\$12.50	\$12.17	\$12.76
2	\$10.86	\$10.69	\$10.69
3	\$10.69	\$10.53	\$10.53
4a	\$ 9.83	N/A	N/A
4b	\$10.28	N/A	N/A

Federal Order and California Minimum Class 1 Prices

Average Hundredweight Prices

Regions	July	August	Sept
Phoenix, Arizona	\$13.69	\$13.32	N/A
Southern California	\$12.64	\$12.30	\$12.89
Portland, Oregon	\$13.24	\$12.87	N/A
Northern California	\$12.37	\$12.03	\$12.62
Boston (Northeast)	\$14.59	\$14.22	N/A

Quota Transfer Summary

For July 2006, two dairy producers transferred 3,412 pounds of SNF quota. July quota sales averaged \$505 per pound of SNF (without cows), average ratio of 2.39. For August 2006, five dairy producers transferred 9,501 pounds of SNF quota. August quota sales averaged \$503 per pound of SNF (without cows), average ratio of 2.46.

Alfalfa Update: August

Northern California: Premium and Supreme alfalfa were steady in a light test with light supplies. Fair and Good alfalfa was steady with moderate demand and moderate to heavy supplies. Retail and Stable hay was steady with moderate supplies. The end of July heat wave put a damper on hay production. Area hay producers are having problems with worms.

Southern California: Supreme and Premium alfalfa was not well tested with good demand and limited supplies. Fair and Good alfalfa was steady with moderate demand and moderate to heavy supplies- with feedlots playing active part. Retail and stable hay was steady with moderate demand and supplies - several producers continuing to put some supplies in the barn. ☀

Supreme Hay Prices

Statewide average prices per ton

Area	7/28	8/4	8/11	8/18
Petaluma	\$167	N/A	N/A	N/A
North Valley ¹	\$170-180	\$170-185	\$170-185	\$170-185
South Valley ²	\$175-190	\$175-195	\$175-197	\$185-195
Chino Valley	N/A	N/A	N/A	N/A

¹North Valley is Escalon, Modesto and Turlock areas.

²South Valley is Tulare, Visalia and Hanford areas.

Alfalfa Hay Sales/Delivery

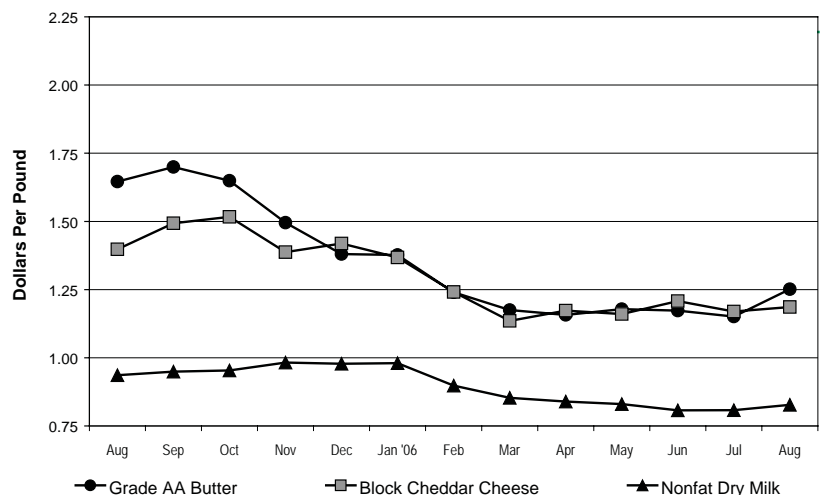
	July	August
Tons Sold ¹	326,707	274,470
Tons Delivered ²	128,161	103,418

¹ For current or future delivery.

² Contracted or current sales.

Alfalfa hay sales, deliveries and Supreme quality prices per ton, delivered to dairies, as reported by the USDA Market News Service, Moses Lake, WA, (509) 765-3611, <http://www.ams.usda.gov/marketnews.htm>

Grade AA Butter, Block Cheddar Cheese, and Nonfat Dry Milk Prices Used in the Calculation of California Class 1 Milk Prices



This article is in response to numerous requests for information regarding the fluctuations of the Class 4a and 4b prices over the last few years and a part of the Department's continuing efforts to offer information and clarification on the framework of the pricing formulas.

Pricing Formulas . . . How Are They Determined? . . .

What Role Do Dairy Producers Play? . . . What Role Do Commodity Prices Play? . . .

Where Do Processors Fit In the Picture? . . .

The Balancing Act . . . The Dilemma . . .

As a result of a national surplus in milk supply, California's minimum Class 4a and 4b prices have fallen significantly, with Class 4a near the federal price support level. These current price levels are below the cost of milk production for many California dairy farms. As of June 2006, the commodity processor's operating margins that were established via the current manufacturing allowances are not adequate to cover the increased processing costs. So, there is the dilemma faced by producers and processors . . . It is the Department's responsibility to balance the dairy producers' need for a fair and equitable milk pricing system with the processors' need to remain competitive within national and international commodity markets.

California's minimum milk prices must allow California commodity products to be competitively priced in the national marketplace. In order to be economically viable, such products must reflect the cost of the raw product (unprocessed milk), the manufacturing costs, and the transportation cost from the plant location to the customer in the national market.

Under the pricing formulas for Class 4a and 4b, it is the interaction of the national supply and demand for dairy commodities (Cheddar cheese, butter, NFDM, and skim whey powder) that determines the general level of minimum prices for producers. When milk supplies are surplus relative to demand, the prices for dairy commodities and the resulting Class 4a and 4b prices will be low. When milk supplies are short relative to commercial demand, dairy commodity prices and the resulting Class 4a and 4b prices will be high. For example, pricing formulas that resulted in \$10 per hundredweight prices can be the same formulas that result in \$14-16 per hundredweight prices months later (with no changes to the formula other than changes in the commodity prices).

Let's Look At Class 4 Prices Over the Last 24 Months

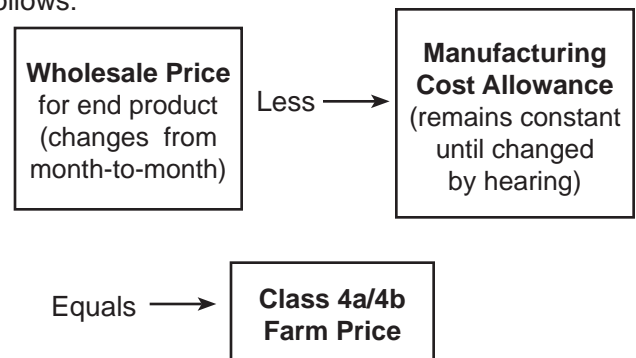
Looking back at the summer months of 2004, dairy producers were enjoying very good Class 4 prices. Since that summer, Class 4a prices (milk used to make butter and dried milk products) have decreased over \$3.00 per hundredweight, while Class 4b prices (for milk used to make cheese other than cottage cheese) have decreased nearly \$6.00 per hundredweight. Dairy producers often ask the question of how can it be, that

when prices were going so well that summer, two years have gone by and they have gone through a slow and steady decline in prices . . . what happened? In order to answer that question, one has to look at how the prices are calculated and what actually affects the pricing formulas to make them change from month-to-month, year-to-year, etc.

Taking A Look At How the Prices Are Calculated

Both Class 4a and 4b prices are calculated each month by using mathematical formulas. These formulas, referred to as "end-product pricing" formulas, essentially use a measure for wholesale prices received by processors less an allowance to cover the cost the processor incurs to convert raw milk into the end product. These formulas have other components, such as yield factors and steps to convert to hundredweight prices, but these factors have not changed recently and do not address the question at hand.

Simply put, the pricing formulas can be expressed as follows:



Wholesale Prices

How does the Department determine wholesale prices for butter, dried milk products and cheese? The pricing formulas use the average of prices at which butter and Cheddar cheese are traded on the Chicago Mercantile Exchange (CME) each month as the measure of wholesale prices for these products. For dried milk products (powder), the Department uses the average prices received by California processors as reported to the Department each month. For the dry whey price, the Department uses the average of the "mostly" price published weekly in the Dairy Market News.

Supply and Demand: These prices increase and

Continued next page

Pricing Formulas - *Continued*

decrease based upon the relationship between supplies of milk (milk production) and the demand for products made from milk. If milk production increases in a given period while the demand for butter, powder and cheese remains relatively constant, then wholesale prices will drop until all product for sale clears the market. Likewise, if milk production should drop off due to bad weather or other factors and demand remains relatively constant then wholesale prices will increase.

Just as milk production fluctuates from month to month, market demand for dairy products ebbs and flows depending on a combination of factors including the time of year (holiday periods and when school is in session), the performance of the U.S. economy and global market conditions for dairy products. Small changes in the relationship between milk produced and the demand for products made from that milk can have significant effects on market prices for dairy products.

Manufacturing Cost Allowances

Manufacturing cost allowances are set by the Department for butter, powder and cheese as a result of testimony and evidence presented at public hearings. However, once set, allowances remain constant until changed through another hearing process.

The Department conducts periodic studies of the butter, powder, Cheddar cheese, and skim whey powder plants throughout the state to determine the cost of processing raw milk into wholesale quantities of finished product. These manufacturing cost summaries are vital in determining the proper level of allowances for each pricing formula. The Department has a long standing history of relying on the audited processing cost study data combined with the relevant economic supply/demand factors to establish the manufacturing cost allowances.

There is no market correcting mechanism to adjust the operating margin for commodity processors. Unlike the Class 4a and 4b prices, the processor operating margins are fixed and largely determined by the establishment of manufacturing cost allowances in the Class 4a and 4b pricing formulas.

Consequently, when the make allowances are not sufficient to cover the processor costs to produce the products, processors may petition the Department to call a hearing to review the manufacturing cost allowances.

In February of 2005, the Department held a hearing on the Class 4a and 4b pricing formulas based on a petition to increase the manufacturing cost allowances partly because of increases in the price for energy (both electricity and natural gas) used in the manufacturing process and also because the manufacturing cost studies released by the Department reflected increases in the cost to manufacture butter, powder, and cheese. As a result of that hearing, the manufacturing cost allowances for butter, powder, cheese and dry whey were adjusted.

So, Why the Decline in Class 4 Prices Since Mid-2004?

One must look at what variables used in the pricing formulas changed between June 2004 and June 2006. There was the February 2005 hearing decision that adjusted the make allowances and the market fluctuations of the prices for butter, NFDM, cheese and Western dry whey commodity prices.

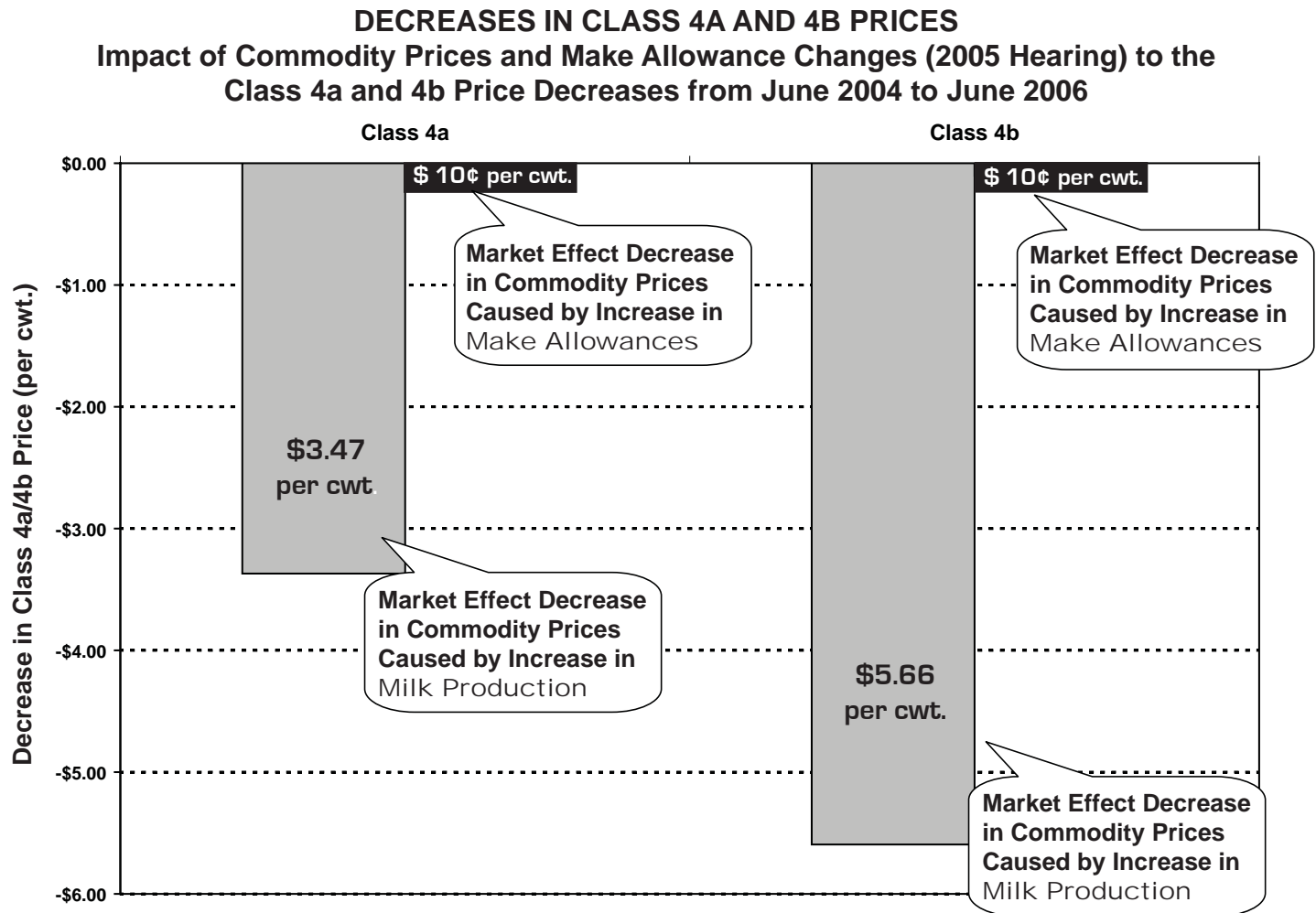
Looking at the commodity prices over the last 24 months . . . CME prices for butter and Cheddar cheese have declined significantly; powder prices received by California manufacturers have declined; and the Western dry whey mostly price has slightly increased. The table below shows the prices for butter, powder Cheddar Cheese, and Western dry whey in June 2004 compared to June 2006:

COMPARISON OF WHOLESALE PRICES^{1, 2, 3} Butter, Powder and Cheddar Cheese June 2004 and June 2006 <i>Prices Per Pound of Finished Product</i>			
<i>Product</i>	<i>June 2004 Prices</i>	<i>June 2006 Prices</i>	<i>Price Difference</i>
Butter	\$1.9160	\$1.1698	74.6¢
Cheddar Cheese	\$1.7648	\$1.2011	56.4¢
Nonfat Dry Milk (Powder)	\$0.8333	\$0.8063	2.7¢
Western Dry Whey (mostly)	\$0.2683	\$0.2910	2.3¢
¹ CME prices per pound for butter and block Cheddar cheese ² Weighted average price per pound received by California manufacturers of powder ³ Mostly price as published by the Dairy Market News The prices above are per pound of finished product. As revealed in the following graph, when applied to the Class 4 pricing formulas and converted to hundredweight prices, these commodity prices reflect almost the entire drop in Class 4a and 4b prices from June 2004 to June 2006.			

Continued next page

Pricing Formulas - Continued

As shown in the following graph, when the commodity prices are substituted into the Class 4 pricing formulas and are converted to hundredweight prices, the drop in commodity prices accounts for over 95% of the entire drop in Class 4a and 4b prices from June 2004 to June 2006.



The Answer to the Class 4 Price Decline Since Summer 2004 . . .

Over ninety-five percent of the price decline for both Class 4a and 4b prices, from June 2004 to June 2006, was due to the commodity price decreases while less than five percent was caused by the February 2005 make allowance adjustments.

Consequently . . .

As long as the manufacturing cost allowances and other miscellaneous factors in the pricing formulas remain unchanged, the fluctuations in minimum class prices every month reflect only changes in wholesale prices for the three manufactured dairy products mentioned above. These prices are, in turn, affected by changes in the amount of milk produced nationwide and changes in the market demand for manufactured dairy products.

Market, News, Weather (DTN) On Dairy Marketing Website

DTN Dairy is a source of comprehensive dairy-specific market, weather, and news information. This site provides a complete package of market analysis and commentary, real-time quotes, milk production information, highly localized weather and industry news 24 hours a day. DTN also includes exclusive updates from the Chicago Mercantile Exchange dairy traders daily. It also provides easy access to local and regional pricing information for distillers grain, soybean meal and cottonseed, as well as a complete database of current bid prices in relation to the producer's operation. The site also provides advice and analysis on current and historic fuel and fertilizer data.

The Dairy Marketing Branch website at www.cdfa.ca.gov/dairy has a link featuring "Markets, Weather, and News" where you can access the DTN information site.

CWT Accepts Export Assistance Bids

Cooperatives Working Together (CWT) announced that it has accepted an export assistance bid for the sale of anhydrous milkfat to Mexico. The bid is from Dairy Farmers of America, Kansas City, Missouri, for the export of 515 metric tons (1.13 million pounds) of anhydrous milkfat to Mexico. CWT will pay an export bonus to the bidder, once completion of the milkfat shipment is verified.

CWT also announced acceptance of a bid from Dairy Farmers of America, Kansas City, Missouri, for the export of 40 metric tons (88,000 pounds) of Cheddar cheese to South Korea. CWT will pay an export bonus to the bidders, once completion of the cheese shipments is verified.

This accepted bid increases CWT's year-to-date (YTD) anhydrous milkfat exports to 1,874 metric tons (4.12 million lbs.). In addition, CWT's YTD cheese exports are 3,977 metric tons (8.75 million lbs.), its YTD butter exports are 5,879 metric tons (12.93 million lbs.), and its YTD whole milk powder exports are 1,924 metric tons (4.23 million lbs.). In the first seven months of 2006, CWT exports add up to the equivalent of 450 million pounds of milk. Since the beginning of the program in July 2003, CWT has helped export the milk equivalent of 550 million pounds.

Previous shipments facilitated by CWT's export assistance program have gone to Algeria, Barbados, Denmark, the Dominican Republic, Egypt, El Salvador, Germany, Guatemala, Honduras, Hong Kong, India, Indonesia, Israel, Japan, Jordan, Kuwait, Lebanon, Mexico, Morocco, the Netherlands, Nicaragua, Oman, Qatar, Panama, Romania, Russia, Saudi Arabia, Singapore, South Korea, Taiwan, Trinidad, Tunisia, Turkey, the United Arab Emirates, and Vietnam. For more on CWT activities, visit www.cwt.coop. 

Class 1 Hearing Date Reminders

Hearing Date: December 5, 2006

Hearing Place: Secretary of State Auditorium,
1500 11th Street, Sacramento, 9:00 a.m.

Alternative Proposals: due no later than 4:00 p.m.
on Tuesday, November 14, 2006

Workshop: Tuesday, November 28, 2006 at the
California Department of Food and Agriculture
Auditorium, 1220 N Street, Sacramento 9:00 a.m.

National Dairy Situation and Outlook – USDA Estimates

Milk Production and Cow Numbers

Monthly: Compared to 2005, USDA estimates that overall milk production across the U.S. was up 1.5% in July, led by New Mexico's 12.6% growth in milk production (on 35,000 more cows and 35 more pounds per cow). California's estimated production was down 0.3% (on 15,000 more cows and 20 less pounds per cow). Among the western states, Arizona was up 1.7%; New Mexico up 12.6%; and Washington was down -4.3%. Three of the top 10 states reported a production decrease.


Quarterly: For the second quarter of 2006 compared to the first quarter of 2006, U.S. milk cow numbers increased to 9.134 million, production per cow was up 2.5%; the net effect was a 2.9% increase in milk production to 46.9 billion pounds. USDA projects that for the third quarter of 2006 compared to the second quarter of 2006, U.S. milk cow numbers will decrease 14,000 cows to 9.120 million cows, production per cow will be down 270 pounds per cow; the net effect would be a decrease in milk production to 44.2 billion pounds.

Milk Prices

Comparing the second quarter of 2006 to the first quarter of 2006, U.S. average milk prices were down to \$12.00/cwt. USDA projects that for the third quarter of 2006, U.S. average all-milk prices will be \$12.05-12.35/cwt.; Class 4b prices will be \$11.12-11.42/cwt; and Class 4a prices will be \$10.68-11.08/cwt.

Utility Cow Prices

Comparing the second quarter of 2006 to the first quarter of 2006, average U.S. utility cow prices were down \$1.10/cwt. to a national average of \$47.79/cwt. USDA projects that utility cow prices will average \$47-49 in the third quarter of 2006.

Information from the USDA-NASS publication "Milk Production" and the USDA-ERS publication: "Livestock, Dairy, and Poultry Outlook." 

- U.S. Milk production during July was up 1.5%
- The number of cows on farms was 9.134 million head, up 80,000 head
- Production per cow averaged 1,664 pounds, 9 pounds more than July 2005
- Nine of the top twenty-three milk producing states showed an decrease in milk production

Milk Production Cost Comparison Summary for California^{1/}
By Quarter, 2005-2006

* Includes an allowance for management and a return on investment

Hundredweight Pool Prices

Month	Quota	Overbase
January '05	\$15.50	\$13.80
February	\$14.96	\$13.26
March	\$14.98	\$13.28
April	\$15.06	\$13.36
May	\$14.60	\$12.90
June	\$14.56	\$12.86
July	\$14.99	\$13.29
August	\$14.65	\$12.95
September	\$15.26	\$13.56
October	\$15.07	\$13.37
November	\$14.35	\$12.65
December	\$14.41	\$12.71
January '06	\$13.91	\$12.21
February	\$12.75	\$11.05
March	\$12.19	\$10.49
April	\$11.90	\$10.20
May	\$11.90	\$10.20
June	\$11.90	\$10.20
July	\$11.71	\$10.01

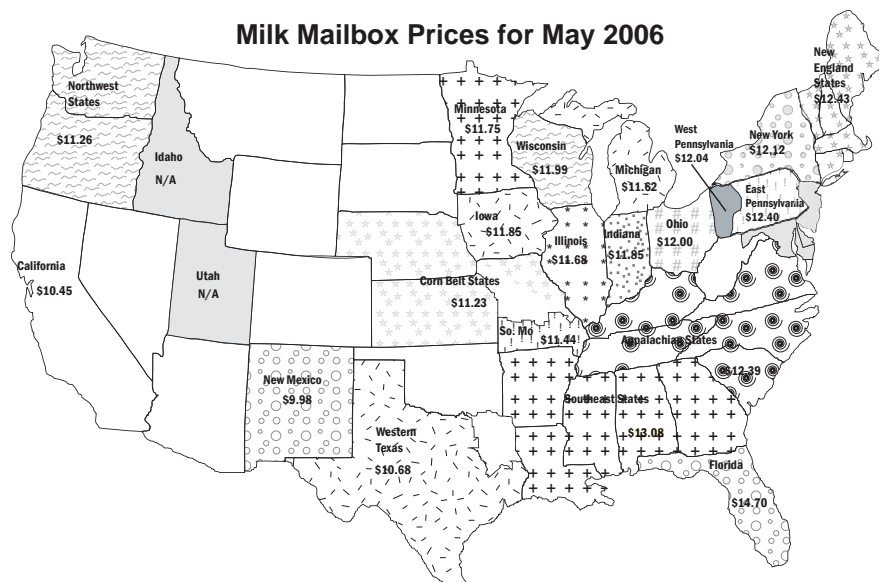
Milk Mailbox Prices

Milk Mailbox Prices in Dollars per Hundredweight

	November	December	January	February	March	April	May
California ¹	\$13.42	\$13.49	\$12.87	\$11.52	\$11.05	\$10.64	\$10.45
USDA ²	\$15.09	\$14.73	\$14.43	\$13.57	\$12.64	\$11.92	\$11.80


¹ California mailbox price calculated by CDFA.

² All federal milk market order weighted average, as calculated by USDA.



In May 2006, mailbox prices for selected reporting areas in Federal milk orders averaged \$11.80 per cwt., \$0.12 less than the figure for the previous month. The component tests of producer milk in May 2006 were: butterfat, 3.63%; protein, 3.01%; and other solids 5.74%. On an individual reporting area basis, mailbox prices decreased in all reporting areas except two, and ranged from \$14.70 in Florida to \$9.98 in New Mexico. In May 2005, the Federal milk order all-area average mailbox price was \$14.48, \$2.68 higher.

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A.G. Kawamura, Secretary

Dairy Marketing Branch
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Milk Pricing Information:
Within California 1-800-503-3490
Outside California 1-916-442-MILK

Dairy Marketing Branch:
Phone (916) 341-5988; Fax (916) 341-6697
Website: www.cdfa.ca.gov/dairy
Email: dairy@cdfa.ca.gov